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## Internationalisation of the State in the Czech Republic: Igniting the Competition for Foreign Investment in the Visegrád Four Region\*

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**Abstract:** This article focuses on a key episode in the Czech political-economic history of the 1990s, the abandonment of 'Czech capitalism', and the switch towards the competition state and an economic model based on foreign investment. The account of the U-turn in the policy approach to foreign investors identifies domestic actors that have had a crucial role in organising political support for the competition state. These actors, which the author calls the 'comprador' service sector, have an important role in mediating the structural power of transnational investors and translating it into other forms of power within the state. These actors also had a major role in shaping the U-turn in policy in the Czech Republic.

**Keywords:** economic policy, state, class, foreign direct investment, Czech Republic

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On 29 April 1998, the Czech Republic rolled out the most generous investment scheme yet seen among the countries of Central and Eastern Europe (CEE). This ignited a race for greenfield investors in the Visegrád Four region (V4). The Czech policy U-turn was followed by a reinvention of the investment scheme in Hungary and by the introduction of investment schemes in Poland and Slovakia [Gandullia 2004: 15–16; C. Jensen 2006]. The Czech U-turn in its relation to foreign investors marked a moment of convergence of state strategies in the region. States became increasingly internationalised, forging economic globalisation by facilitating capital accumulation for transnational investors. After the attempts to promote national capitalisms failed in the Czech Republic, Slovakia, and – to a lesser extent – in Poland, the attraction of foreign direct investment has become a priority throughout the region [Bohle 2002; Bohle and Greskovits 2006]. While internally oriented state strategies dominated policy making in the CEE throughout the 1990s, by the end of the decade, state economic strategies converged towards

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different models of the competition state. The V4 developed a specific model of the competition state, aimed at attracting strategic foreign direct investment (FDI) through targeted subsidies [see Drahekoupil 2007].

This article focuses on a key episode in Czech political-economic history, the abandonment of 'Czech capitalism' [Myant 2003], and the switch towards the competition state and an FDI-oriented accumulation. The account of the policy U-turn identifies domestic actors that have a crucial role in organising political support for the competition state. These actors, which I call the 'comprador' service sector, have an important role in mediating the structural power of transnational investors and translating it into other forms of power within the state.<sup>1</sup> The political analysis in this article also deconstructs common misconceptions about the political support for the competition state. It shows that the competition state has broad social support that goes beyond party divisions, even though it is often politicised along party lines.

Why and how did the Czech Republic reconsider its policy towards foreign investors? And, what is perhaps more puzzling, why did it introduce an approach favourable to foreign investors only in the late 1990s? Existing literature on the region offers a number of ways to look at the problem. First, the 'transitology' literature that dominated the academic mainstream in the aftermath of 1989 has attributed analytic primacy to internal determination of the post-communist transformation. This rationale leads us to investigate the domestic determination of policy pathways. Respective analyses then focused on domestic actors, networks, projects, and constraints [Stark and Bruszt 1998; Dobry 2000; see Bohle 2000]. Second, the 'transitology' literature was later criticised by neo-Gramscian scholars who emphasised the centrality of the global context of transition and underscored its external determination. This paradigm then identified foreign investors and their domestic allies as the major actors in an environment with weak domestic social forces, most notably capital and labour [Bohle 2002; Holman 1998, 2004; Shields 2003, 2004; van der Pijl 2001]. Finally, from an economic sociology perspective, Bandelj [2007] has pointed out the importance of social and cultural ties between host and home countries and the embeddedness of investors in social structures, cultural understandings, and power relations.

I argue that the belief in the importance of the international political-economic environment for transition strategies, which led initially to false predictions about the prominence of FDI in the post-communist transition, was ultimately not mistaken. The international environment in which transition and post-transition policy-making took place indeed had a crucial role in explaining final outcomes. But there is a missing link. The pressures of the transnational environment had first to be translated, embodied, and expressed by key actors in domestic politics and within the state.

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<sup>1</sup> As explained in detail below, 'comprador' refers to a structural link of the sector with transnational capital.

My analysis below will show that domestic politics plays a crucial role in this process. Domestic politics, however, cannot be understood as completely internally determined. It must be treated as an instantiation of locally materialising transnational processes. Domestic politics understood as transnationally constituted allows comprehension of both the initial inward-oriented outcomes and the later shift towards the competition state. Theoretically, this article draws on a strategic-relational state theoretical perspective [see Drahokoupil, Van Apeldoorn and Horn 2008]. Accordingly, the structure and organisation of the economy, institutions, and ideas have a major role in constituting social forces and in mediating their relative power and social influence. These structural features produce a 'field of force' [cf. Kalb 1997] that exerts pressures and sets limits on what is achievable. In other words, they constitute a (strategically-selective) environment that provides advantages to some actors and strategies over others. Yet, actual outcomes are produced by strategic actors in social struggles. In the transnationally constituted domestic politics, some structural opportunities are enacted – or some social mechanisms are activated – while other are suppressed or muted. Combining political economy and political analysis creates an approach that complements and goes beyond Bandelj's economic sociology perspective. It identifies actors pursuing their interests, which reduces the degree of contingency in what the economic sociology approach depicts (merely as) culturally and socially embedded strategies. It also uncovers the power relations overlooked by such an approach by analysing the structural power inscribed in the political and economic environment and the processes whereby it was translated into actual outcomes. This kind of political analysis complements the alternative approach based on regression models. The latter makes it possible to assess the influence of individual factors in a more formal and systematic way, yet it is susceptible to impressionist and at times misleading interpretations of actual political strategies (see my review of Bandelj on the pages of this journal, *Vol. 44* (6): 1224–1228).

Below I first present my interpretation of the comprador service sector as a force that mediates the structural power of transnational capital and organises the political support for the competition state. Second, I outline the struggle in the early 1990s that gave rise to the 'Czech way', despite the fact that the international political-economic environment provided advantages to the competing externally-oriented project. Finally, I analyse the policy U-turn in which the Czech state reconsidered its approach to FDI and introduced targeted investment subsidies. In particular, I identify the strategic role of the comprador service sector in this move and also the role of other actors, including the EU and multinational investors. Publicly unavailable data were collected through archival research and qualitative interviews with key policy makers, politicians, and business elites [see Drahokoupil 2008].

### **The structural power of the multinationals and the strategic role of the comprador service sector**

The literature on (FDI-)dependent development has emphasised the crucial role of domestic actors in the political coalitions that underpinned the projects of development relying on FDI in global peripheries. Poulantzas used the term 'comprador bourgeoisie' to describe the underlying class relations. The comprador bourgeoisie was defined as 'that fraction whose interests are entirely subordinated to those of foreign capital, and which functions as a kind of staging-post and direct intermediary for the implantation and reproduction of foreign capital' [Poulantzas 1976: 42; cf. Baran 1957]. In CEE, Eyal, Széleányi and Townsley [1998: Chapter 5] identified foreign investors with their comprador intellectual allies as one of the major candidates for a new propertied class. Holman argued that the new power elites in the region cannot be characterised as a propertied comprador bourgeoisie, but rather as managerial and administrative elites that have the same function as that of the comprador bourgeoisie [Holman 2004: 223]. Lane proposed that a transnational political class, an alliance between internal elites and external global political class in particular, was a crucial agent of change in CEE in the 1990s, which effectively precluded the development of social democratic or corporatist forms of national capitalism [Lane 2005, 2006]. From an elite perspective, Machonin, Tuček and Nekola [2006] observed that the influence of domestic elites is limited by an 'apparent hegemony of foreign capital'. They argued that the influence of local managers working for foreign affiliates is based not on wealth, but on a 'mandate from abroad'. However, the comprador segments are not sufficiently specified in these accounts. Holman and Lane offer an analytic understanding; yet they do not identify differences between domestic elites in their approach to FDI and fail to distinguish between the limited importance of FDI in the early 1990s and its hegemonic role later in the decade.

I describe the domestic actors linked to FDI as the comprador service sector, which comprises various groups providing services to foreign investors. It includes local branches of global consulting and legal advisory service firms and their local competitors, companies providing other services to foreign investors, and officials from FDI-related state bodies. Structurally, this sector is not a bourgeoisie, as it constitutes neither a propertied class, nor a professional managerial class whose interests are directly linked to that of company owners. For this reason, I prefer to call them a service sector rather than bourgeoisie. Yet, recent trends, most notably the emergence of regional developers such as the IPEC Group<sup>2</sup>, indicate processes of embourgeoisement within this sector. Without implying any value judgement, I refer to this group as comprador, as it is defined by its structural connection/link to transnational capital. From a more agent-oriented perspective, this group could largely be seen as an 'epistemic community' [Haas 1992] or 'institutional entrepreneurs' [DiMaggio 1988]. However, such an

<sup>2</sup> See [www.ipec-group.com](http://www.ipec-group.com).

approach would ignore the importance of the 'social relations of production' (like in Marx) and of the Weberian 'market situation' in constituting this group. In particular, it would overlook the importance of the structural connection/link to transnational capital and foreign-oriented economic model (or accumulation strategy) in the formation of the interests and strategies of this group. The structural link to the structural power of capital provides an important source of power for this sector. A 'market situation' in which service providers could charge foreign investors fees in excess of the local market average represented an important pull factor that united and consolidated the comprador service sector. Thus, the group was not installed by foreign capital to work on its behalf. Instead, it took shape in the process in which domestic actors were seeking linkages with foreign investors, as soon as the structure of opportunities created such possibilities. The comprador is thus not an essentialist feature of a group: it is a class position created by the changing structure of opportunities and political-economic relations that – given the accompanying 'market situation' – attracts people with the necessary skills (including those who previously supported the national, inward-oriented project).

The structural power of capital derives from the dependency of the state and society at large on the investment decisions of those who control key productive factors (e.g. the possibility of investment strike and state revenue dependence).<sup>3</sup> Capital mobility has greatly increased the power of transnational investors, as they are able to locate their investment outlets in the regulatory environment of their choice and have the possibility of exit (at varying relocation costs). In CEE, the neo-liberal transition strategies greatly facilitated the structural power of transnational investors as they abolished the Comecon<sup>4</sup> markets and opened the domestic economies to global competition [Boer-Ashworth 2000]. CEE economies specialising within the Comecon in complex sectors [see, e.g., Berend 1996] were not able to compete on the world market and had to downgrade and diversify their production profiles in order to be able to sell there [see Myant 2003]. Multinational enterprises rather than domestic companies controlled the necessary know-how and distributional networks and were thus major agents of enterprise revival and reintegration of CEE into the world market [Myant and Drahokoupil 2010].

But the structural power of capital does not predetermine a single outcome; nor does it predetermine a single policy even in economies as highly dependent on FDI as those in the V4. The cumulative empirical evidence contradicts the trade-off between redistribution and investment implied in the 'structural dependency' thesis as formulated by Przeworski and Wallerstein [1988]. First, a variety of domestic political-economic strategies can be competitive in the inter-

<sup>3</sup> See, inter alia, Hirschman [1970]; Przeworski and Wallerstein [1988]; Offe and Ronge [1975]; Gough [1979]. For a detailed discussion of the structural and agency power of capital, see Gill and Law [1989] and Farnsworth [2004].

<sup>4</sup> The Council for Mutual Economic Assistance (Comecon) was disbanded at the final council session on 28 June 1991 in Budapest.



national economy, including those relying on high spending and taxation [Hall and Soskice 2001; Rodrik 1997]. Second, physical and human capital endowments can facilitate the pursuit of policies that are against the immediate interests of capital even in a very open economy [Shafer 1994; Gereffi 1995]. Third, research on the actual locational decisions of multinationals has shown that these tend to be determined primarily by proximity and market access and by the skills and educational attainment levels of the host economy's workforce; there is no evidence that the degree of market regulation or non-wage labour costs suppress the level of inward investment [Cooke and Noble 1998; Cooke 2001]. Given that the structural constraints facilitate a wider variety of policies (at least from the perspective of advanced capitalist countries), the discursive constitution of what is possible, or what the markets and investors 'really want', becomes often more important and limiting than the actual 'hard' constraints [Watson and Hay 2003]. In this context, the political activities of the comprador service sector had a major role in actively contributing to the discursive construction of the constraints and limits of the political economic environment and the imperatives of capital mobility in particular.

Capital mobility, however, constrains the autonomy of policy makers in the V4 region, as many investors regard the region as a single investment location, with EU market proximity, good institutional infrastructure, and a comparable workforce and labour costs. This puts structural pressures on policies that are deemed important for the investors. It also allows investors to arbitrage locations in order to get additional benefits in the form of investment subsidies. This can make some cost considerations that are generally marginal in location decision an important factor. In the context of the early stage of FDI inflows addressed in this article, the avoidance of political risks that increase the costs of internationalisation was one of the major concerns for the multinationals. The latter face significant disinvestment costs once invested in a foreign market. As a risk management strategy, investors tend to seek explicit commitments to FDI-friendly policies that can be used as a political 'stick' against policies that may represent an 'expropriation of [expected] revenue streams' [N. M. Jensen 2003]. From the perspective of many investors and their advisers in the early 1990s (including those I interviewed), such commitment was missing from the Czech Republic. The introduction of the investment scheme package was a signal to investors that the Czech Republic was open for their business.

Functionally, the comprador service sector is a nodal point and organiser of the transnational power bloc centred on multinational investors. These comprador blocs also include significant fractions of domestic capital, which are becoming largely internationalised and/or subordinated to international investors. The comprador sector constitutes an important link between investors and states, which is missing from the state-investor bargaining models that dominate the scholarship on FDI and the power of capital in general [e.g. Przeworski and Wallerstein 1988; N. M. Jensen 2003; Meyer and Jensen 2005]. Governments are

not social actors independent of other social forces, including investors. The actual policy outcomes are products of the agency of particular social forces mediated through structures of representation inscribed in the state. In this spirit, Bohle and Husz [2005] pointed to the congruence of interests between the investors and national elites in the V4. To be more precise, I argue that it is the privileged position that social forces connected to FDI gained within respective states that explains the support for FDI promotion and the competition state in general. The comprador service sector helps to translate the structural power of transnational capital into tactical forms of power that enable agential power to work in sync with the interests of the multinationals. The notion of tactical power introduces an intermediate level between the structural and agential faces of power. Tactical power, or what others call agenda-setting power [see Hay 2002: 174–178], refers to the ability to control the settings of interaction or the respective field of force [Wolf 1990]. It enables the structural power to work in sync with its agential counterpart.

Power through agency is exercised by direct participation of business within and in relation to the state institutions. The particular channels of representation that the comprador service sector and foreign investors organised and took advantage of are analysed below. As mentioned above, the success of these activities cannot be attributed to the strategy of the comprador sector alone, but rather to its connection/link to the structural power of the investors (power through agency). They could thus offer carrots in the form of political capital from job creation and imports of the sophisticated technology associated with greenfield investment by multinationals. The (perceived) risk of an investor deciding not to invest in the country because of a lack of FDI-friendly policies then represented a political ‘stick’ the sector could use. In the Czech context these ‘carrots and sticks’ have become particularly effective in times of crisis, when the failure of the alternative, internally oriented accumulation strategy became apparent.

As noted above, strategic agency can have a crucial role in shaping the understanding of the international political-economic imperatives. The tactical, or agenda-setting, strategies pursued by the comprador service sector often facilitated the learning process in which policy makers came to understand the imperatives of the structural power of multinationals. In the Czech Republic, where the internally oriented model and the reluctance to implement FDI-friendly policies became particularly entrenched, the comprador service sector became especially organised and implemented a number of activities aimed at redefining the approach of policy makers to FDI. It thus taught lessons on the importance of foreign investors for the domestic economy and on the need to implement policies that would favour them.

At the same time, however, the strategic role of the comprador service sector should not be overestimated. While they had a major role in redefining the approach to FDI in general, their specific role in policy design was largely limited to defining the competition strategy based on attracting investors through targeted



subsidies. A comprehensive understanding of the Czech path of adjustment to international political-economic pressures, including the transformation of social policies and the welfare state, would also have to take into account the strategic agency of other forces, including domestic capital and labour and their interplay with various path dependencies and structural and institutional endowments [see, e.g., Bohle and Greskovits 2007; Drahokoupil 2009]. This analysis focuses only on the shift in the approach to FDI in general and on the narrow area of industrial policy.

### **The early 1990s: the 'Czech way' against the odds**

There were good reasons to expect foreign investment to dominate post-communist economic restructuring in CEE. Strategically, reformers in CEE were well integrated into a transnational policy network where openness to FDI was the norm. Western politicians and many advisors have seen FDI as a 'Marshall Plan for Eastern Europe'. USAID-financed investment bankers embarked on a mission to handle the sale of state-owned enterprises to foreign investors. They had direct access to key decision-makers in Eastern Europe [Meaney 1995]. Structurally, the neo-liberal strategy of the region's integration into global capitalism or the 'American approach' [Gowan 1995, 1996; cf. van der Pijl 2006: 237–242] provided strategic advantages to FDI-reliant strategies. This doctrine installed political-economic structures that made the exigencies of global accumulation a political prerequisite for national strategies in the region. The peripheral mode of integration on which CEE embarked made the region structurally dependent on foreign capital [cf. Boer-Ashworth 2000; Bohle 2006]. These structural exigencies represent the main mechanism that account for the emergence of the competition state in CEE. However, they were not translated into political outcomes until the end of the 1990s.

In the early 1990s, state strategies were actually open to foreign direct investment in Hungary only. The approach to FDI in general and privatisation in particular has been quite hostile to foreign investors in the rest of the V4. Yet, the outcome is puzzling only in the Czech case. Only in the Czech Republic were foreign investors interested in high-commitment involvement, while state managers controlled enterprises and could have transferred them to foreign investors if they wished.<sup>5</sup> The structural constraints did not allow for open outcomes elsewhere.

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<sup>5</sup> The bulk of enterprises were privatised through privatisation projects submitted by enterprise managers and the outcomes were often in line with their interests. However, the privatisation method was decided by the reformers, and managers had to anticipate their expectations when designing privatisation proposals. There is no evidence that managers influenced the method of privatisation; on the contrary, research shows that they had very little power and agency when the privatisation method was being designed [Orenstein 2001; Gould 2001; Appel 2004].

First, unlike Hungary and Poland, Czechoslovakia did not inherit significant debt and thus did not have to subordinate privatisation strategy to obtaining cash in hard currency as the Hungarians did. Second, unlike in Poland and Slovakia, foreign investors were interested in taking over the commanding heights of the Czech economy. Finally, unlike in Poland, effective control over enterprise privatisation lay with Czech policy makers rather than with enterprise insiders.

Czech state strategy was shaped in a struggle between two groups within the state. The 'industrialists,' on the one hand, advocated a privatisation programme that would find strategic owners, foreign investors, for main enterprises. Most notably, Jan Vrba, then Minister of Industry and Trade, believed that only foreign investors could provide access to new technologies, know-how, distribution networks, and capital investment. He planned to bring foreign investors to what he identified as the core of the Czech economy. The externally oriented strategy had wider support within the ministries. It came mainly from the 'business elite', that is, bureaucrats linked to enterprise managers. On the other hand, neo-liberal reformers – who, in contrast to the industrialists, were involved in designing the general transition strategy – promoted a hands-off, voucher-based privatisation model. The hands-off model was incompatible with FDI entry, which demanded an active approach by the state to secure the contractual commitments required by investors. What is more, the neo-liberals did not favour the participation of foreign investors and preferred the creation of a domestic capitalist class [Kupka 1992; McDermott 2002; Appel 2004].

Vrba offered the leading Czech companies for sale to foreign investors in June 1991. There were a number of foreign investors ready to bid for the commanding heights of the Czech economy. In retrospect, Czech reformers and intellectuals close to Klaus explain the relative absence of foreign investors in the privatisation of the early 1990s by the lack of interest on the part of foreign investors.<sup>6</sup> The historical record, however, suggests that this was not the case. There was considerable interest among foreign investors to buy out Czech state-owned enterprises at that time. Vrba and his team managed to put together a list of buyers for what they saw as the commanding heights of the Czech economy. Vrba's team managed to conclude a number of deals with foreign investors, most notably the transfer of Škoda to Volkswagen. The investors perceived the country as a prospective production site for exports to the East. Moreover, Volkswagen's acquisition of Škoda had a 'herding effect', drawing other investors into the region. The interest of foreign investors in taking part also in the privatisation of other companies that were actually privatised in the 'Czech way' is confirmed by various privatisation records [e.g. Myant 1999; McDermott 2002; Pavlínek 2002]. Box 1 illustrates the situation in the case of lorry manufacturers.

<sup>6</sup> See, for instance, the interview with Dušan Tříška in *Profit* (a business weekly), 2 May 2006, or Jiří Schwarz's speech at the Czech-German colloquium 'Reform and Transformation' in Prague, 6 March 2001, later published as Schwarz [2003].

**Box 1. How Czech truck manufacturers were not sold to foreigners**

Lorry production in Czechoslovakia was fragmented, with three major manufacturers: Liaz, Tatra, and Avia. Vrba's Ministry of Industry and Trade favoured a more interventionist approach and reorganised the sector before privatisation. Yet, this statist strategy was difficult to pursue, as it met resistance from Klaus and his allies as well as from the management of the manufacturers themselves, which wanted to continue operating independently. In this context, the Ministry looked for buyers for the individual manufacturers. On 9 March 1992, the *Wall Street Journal* reported on the process as follows: 'Mercedes had to outbid France's Renault S.A. and Iveco, a unit of Italy's Fiat S.p.A., to snare two major truck companies in Czechoslovakia. A third Czechoslovak truck producer, Tatra, is still being pursued by Western investors. "If we want to defend our European leadership, then we have to do something in Eastern Europe," Mr Werner [of Mercedes' management board] declares.' Mercedes indeed signed letters of intent to take stakes in two major truck companies, Avia and Liaz, in March 1992. Liaz, however, turned down the deal with Mercedes, citing Mercedes' intention to keep only part of the operation as the reason. Claiming to produce an excellent truck ideal for rough terrain, Tatra rejected a possible joint venture to assemble Iveco. Instead, it opted mainly for voucher privatisation, which guaranteed the management protection from state-led rationalisation across the sector or from a possible sale to a foreign firm. Vrba linked the management's decision to intervention from Tríska, one of Klaus's close collaborators, who visited the factory to advise the management to adopt the voucher model in order to avoid their likely dismissal after Mercedes' entry (interview by the author, 21 October 2005). Negotiations at Avia were accompanied by long delays, with Mercedes demanding protection from the domestic market. Mercedes finally pulled out in 1993 without giving any clear explanation as to why.

It was thus the state strategy rather than the lack of interest among the investors that explained the relative absence of foreign investors in the restructuring of Czech industry in the early 1990s. Crucial in this context was the victory of the neo-liberals in a path-shaping political struggle that culminated in June 1992 [see Drahekoupil 2008: Chapter 3]. The neo-liberals mobilised enterprise managers, who feared losing their positions after a foreign takeover, to support voucher-oriented strategies in individual enterprises. More importantly, they marginalised the industrialists in a political struggle within the state by playing on anti-communist sentiment [see Gould 2001; Appel 2004; Drahekoupil 2008]. Many of the investors were thus turned down, especially after Vrba and his team were pushed out of power. What is more, some of the investors pulled out from the privatisation negotiations, as Klaus and his team were not willing to allow the state a more active role in restructuring, which would have guaranteed the contract commitments sought by the investors [McDermott 2002].

Czech strategy reflected the concerns of local neo-liberals. It prevented the earlier internationalisation of the commanding heights of the Czech economy and the emergence of foreign-led capitalism similar to the Hungarian model. Instead,

the policies actually implemented produced a distinctive economic dynamic, Czech capitalism, and created a coalition of reform winners that provided political support to the internally oriented project. At the same time, the neo-liberal strategy helped create conditions that offered structural advantages to foreign investors, which later, when the economic dynamics of Czech capitalism were exhausted, pushed the state strategy in the externally oriented direction. These structural conditions – which were largely in place throughout the 1990s – were translated into policy outcomes by the end of the decade.

### **Crisis-induced internationalisation: the policy turnaround in the Czech Republic**

On 30 November 1997, Prime Minister Klaus handed in his government's resignation in the wake of a political and economic crisis. The departure of Klaus and his government marked the dissolution of the Klausian project [see Myant 2003] and a profound reorientation of state strategy in relation to foreign investors. The economic programme of the caretaker government of Josef Tošovský, who was sworn in on 2 January 1998, included the aim of attracting foreign direct investment. In April 1998, the Tošovský government introduced a package of investment incentives with the aim of attracting foreign investment. This policy was then implemented by the Social Democrats, who took power in June 1998. The Social Democratic government would make attracting foreign investors a focal point of its economic strategy. It is often thought that the outward-oriented policies, FDI incentives in particular, came with the change of government, when the Klaus-led coalition moved into the opposition [e.g. Orenstein 2001: 93]. However, the historical record shows that the process of policy reorientation had much broader sources, which were largely independent of party politics. The political change may have 'radicalised' and catalysed the pace of the policy change, but it was not a decisive factor. As will be shown below, the policy U-turn has to be related to the structural power of transnational capital, as translated by its domestic allies – the comprador service sector – and amplified by the exhaustion of the domestic accumulation strategy.

It is often forgotten that it was already the Klaus government, and indeed Klaus himself, who made the decision to reconsider their hitherto negative approach to FDI promotion and provide subsidies to foreign investors in 1997. This contradicts the party-pluralist explanation. The history of the outward-oriented project, however, goes further back in time. It was already being developed within the state at the time when the Klausian inwardly oriented strategy was dominant. There was a group within the state that had been actively working on the promotion of FDI. Located at the Department of Industry and Trade, these bureaucrats – a state fraction of the comprador service sector – faced a hostile environment. Nevertheless, they managed to thrive. In November 1992, they founded a foreign investment promotion agency: CzechInvest – at that time called the Czech

**Table 1. CzechInvest's budget (in millions of Czech crowns)**

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
State funds	5.2	8.2	14.9	20.2	28.2	36.8	52.2	83.8	148.4	166.1
PHARE funds	2.1	13.4	22.3	30	22.9	21.7	21.5	50.9	0	0
Total	7.3	21.6	37.2	50.2	51.1	58.5	73.7	134.7	148.4	166.1
Spent on FDI	7.3	21.6	37.2	50.2	51.1	58.5	73.7	113.7	126.4	139.1
Spent on sourcing	0	0	0	0	0	0	0	20.1	21.9	26
Total staff	14	18	24	28	32	31	35	44	54	63
State funds as % of total	71	38	40	40	55	63	71	62	100	100

Source: MIGA-FIAS (2005). It is important to note that some of the assistance received was free of charge and not reflected in the budget. The approximate annual exchange rates used are: 1 USD = 27 CZK (1993-1996); 1 USD = 33 CZK (1997); 1 USD = 30 CZK (1998); 1 USD = 34.64 CZK (1999); 1 USD = 38.59 CZK (2000); 1 USD = 38.04 CZK (2001); 1 USD = 33.3 CZK (2002). This table reflects some rounding of the decimal places.

Agency for Foreign Investment. As recalled by Vladimír Dlouhý, then Minister of Industry and Trade, a Phare-financed Irish advisor had a crucial role in persuading Dlouhý of the utility and necessity of having such an agency.<sup>7</sup> The EU's financial support was vital for the agency in the years that followed. The EU not only financed advisors that used Irish experience to make the case for the existence of an investment promotion agency, but also provided a crucial source of funding. Ireland was perceived as the first European tiger to emerge and transform its semi-peripheral location to make it an export-led 'climber' within the international hierarchy [cf. Smith 2005]. Many within the EU apparatus and in the CEE states saw CEE as Ireland's natural successor. The region was meant to replicate the 'Celtic tiger' experience within the EU.

As Table 1 shows, external resources covered up to 62% of CzechInvest's budget in the early 1990s. Moreover, some of the aid to CzechInvest was provided in kind and was not reflected in CzechInvest's budget. Jan Havelka, CzechInvest's founder and CEO in 1993–1999, very much underscores the importance of foreign aid for the organisation in the early 1990s. This is reflected in his estimate that around 80% of CzechInvest's budget was paid for by foreign taxpayers in some years of the early 1990s. Havelka, who was recruited by foreign advisors because of his experience as a project manager at the Kuwait Investment Office and as an advisor to the Slovak Minister of Foreign Affairs, explains the importance of the EU in developing the foreign investment promotion agency in an environment that was very hostile to such activities:

<sup>7</sup> Dlouhý's contribution in CzechInvest [2002: 8–10].

[External support was indeed important.] I was supported by people from the World Bank and the European Commission. Thus, I was able to obtain massive funding from Phare in the early years. This gave me the image as someone who knew what he wanted in the eyes of [Minister of Industry and Trade] Dlouhý. I had the confidence of people who [the Minister] trusted. [...] After I persuaded Dlouhý, I could afford such escapades as arranging – behind the back of the Ministry – permanent representations abroad, financed by Phare.<sup>8</sup>

Faced with a hostile environment both within the government and among the general public, Havelka's strategy focused on changing the public's perception of foreign investment and winning the government's trust and gaining its support. In order to change the perception among state officials and to make allies among them, CzechInvest used its Steering Committee, which included representatives of other government institutions, the private sector, and banks, who were appointed by the Minister of Industry and Trade. CzechInvest employed internal public relations efforts to win over the understanding and trust of the government and especially the Ministry of Industry and Trade. For instance, CzechInvest invited government officials on study tours and remembered their birthdays and other personal events. To convince the public of the potential benefits of FDI, CzechInvest showcased the positive experiences of other countries and promoted the agency and its efforts through constant press releases. The agency needed to show quick results in order to demonstrate the positive impact of FDI. 'Greenfield' projects were found suitable for these purposes. Thus, it focused on attracting greenfield manufacturing investments in the automotive, electronics, and precision engineering sectors. Such investment projects were regarded as having great potential to create good publicity through job creation, which also represented an important source of political capital that could be offered to politicians. These projects also fitted with the common belief about the traditional strength of Czechs in the area of manufacturing, their technical skills, and the country's trained labour force.

In 1996, CzechInvest established the Association of Foreign Investors (AFI) to serve as an official body representing the interests of investors to the government and to link local service providers with foreign investors. Apart from its business function, AFI proved to be an important vehicle for soliciting and channelling investors' concerns to the government, and it helped CzechInvest to finance activities aimed at promoting investment-friendly policies within the government. AFI funds represented 5–10% of CzechInvest's total funding. AFI's activities were aimed at building a 'working relationship' between investors and the government. They include breakfast meetings, unofficial meetings with ministers, unofficial contacts with investors, and the AFI/CzechInvest-sponsored annual awards such as Best Investor, Most Successful Industrial Zone, and Most Successful Supplier. AFI and CzechInvest also initiated working groups on a

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<sup>8</sup> Interview with Jan Havelka, Prague, 30 December 2005.



Table 2. Timeline

	GDP growth (%)	GFCF growth (%)*	Budget balance (CZK bn)	Current account / GDP (%)	Trade balance (CZK bn)**	Exchange rate USD (end of period)	Key events / policy measures
1995	5.8	19.8***	7.2	-2.5	-63.1****	26.6	
1996	4.1	9.9	-1.6	-6.6	-119.4	27.33	A string of bank failures; <b>AFI established</b> ; <b>February</b> Central bank widens currency fluctuation band; <b>June</b> CB tightens monetary restraint
1997	Q1 1.0 Q2 -0.4 Q3 -1.6 Q4 -1.9	0.6 -7.7 -10.9 -4.6			-30.3 -27.4 -20.9 -14.2	29.2 32.05 32.79 34.64	<b>April</b> Government responds to growing budget deficit with expenditure cuts ('Package I'); <b>May</b> Central bank allows currency to float; Currency speculation and IMF criticism leads the government to further budget cuts ('Package II'); Strains in coalition intensify (party-financing scandals); Key ministers replaced; <b>August</b> Government offers subsidies to Intel; <b>November</b> GM offered subsidies; Mr Klaus resigns
1998	Q1 -1.7 Q2 -1.1 Q3 -0.3 Q4 0.0	-6.6 4.2 2.7 -3.0			-13.0 -20.9 -25.0 -23.7	33.68 33.42 29.94 29.86	<b>January</b> Interim government formed under Mr Tošovský; <b>April</b> Government approves investment support scheme commissioned by the Klaus government in one of the 'packages'; <b>July</b> Minority Social Democrat government formed
1999	-0.8 1.3	-0.9 -3.3	-29.3 -29.6	-2.0 -2.4	-82.7 -19.7	29.86 35.98	

Source: Czech Statistical Office (statistics), author's compilation (events).

\* Gross fixed capital formation

\*\* Constant prices of 2000

\*\*\* Source: OECD Economic Outlook, December 2001

\*\*\*\* Current prices

number of issues, including labour law, tax accounting, residency issues, and real estate development.

However, these attempts to set the agenda and create channels of representation to exercise agency-power had only limited success throughout the mid-1990s. The government was refusing to provide preferential treatment to foreign investors, as promoted by CzechInvest. This had some apparent consequences as far as investors' locational decisions were concerned. Petr Hájek, working at CzechInvest at that time, illustrates this with the example of a situation where a Japanese corporation asked for an import duty waiver on machinery it was going to import for its production plant. Klaus rejected the deal and the investor went to another country where it was able to receive such concessions. The turning point came in 1997 when Intel and General Motors (GM) were looking for investment sites in Europe and explored possibilities in the Czech Republic. According to Havelka, Klaus became interested as he favoured American investors. CzechInvest used their familiar line that the Czech Republic was not competitive without investment subsidies, which were provided by direct competitors, most notably Hungary. In contrast, Klaus believed in the country's natural comparative advantages. Yet, the negotiations with Intel and GM demonstrated the importance of 'non-natural' factors.

The combination of these hard lessons, a mounting economic crisis, and the fact that the Czech Republic was a regional laggard in terms of FDI inflows made the Klaus government reconsider its approach to foreign investors (see the timeline in Table 2). When the limits of internally oriented accumulation – the 'Czech way' – became apparent, the only alternative seemed to be the externally oriented approach. The agenda-setting activities of the comprador service sector not only helped to construct such an understanding, but also offered an easy policy solution at a time of crisis: investment incentives. Under these circumstances, the sector could capitalise on their connection/link to foreign investors and translate their structural power into political capital, giving the comprador service sector a privileged position in Czech policy making. This lent the agenda-setting activities and channels of representation the sector had organised considerable potential for political influence.

The year 1997 saw a drop in private investment, which derailed the balanced-budget policy. Rising consumer demand started to inflate labour costs and stimulated imports. The current account swung into deficit [see Myant 2003]. In April 1997, the government reacted to the growing budget deficit, the pressure on the currency, and IMF criticism with an emergency 'package' of budget cuts. With key economic ministers resigning from the government, currency speculation led to another 'package' of emergency measures in May 1997. In August 1997, the government offered Intel a package of subsidies, as it had demanded. In November 1997, just a few days before its resignation, it offered a similar package to GM. As a part of the 'little packages' released in response to the economic crisis, Klaus assigned the Minister of Industry and Trade with the task of drafting

an investment-incentives scheme. However, political developments did not allow Klaus's team to vote on the proposal from the Ministry. Thus, it was the Tošovský government that approved the investment support scheme in April 1998.

Witnessing the many failures of domestic enterprises privatised with the voucher method or in the 'Czech way', most Czech economists began to perceive foreign capital as a major opportunity to stimulate economic development. Moreover, by the mid-1990s, various 'economic experts', mostly young economists working at investment banks or finance consulting companies, established prominence in media discourse. They not only emphasised the need to attract foreign capital, but also called for the introduction of investment subsidies. At the same time, CzechInvest's PR efforts proved to be successful, and CzechInvest's experts often commented publicly on FDI-relevant issues and emphasised the need for an investment support scheme.<sup>9</sup> Thus, when the decision to introduce an investment support scheme was reported in the media, it was accompanied by praise from established commentators.<sup>10</sup>

Investment incentives, however, became a political issue, structured along party lines, with ODS being critical of the scheme and the Social Democrats (ČSSD) embracing investment support. This gave rise to the impression that investment support actually came with the new government. The leader of ODS's MPs, Vlastimil Tlustý, expressed strong disagreement with the investment scheme proposed by the Tošovský government, despite the fact that the caretaker government presented the policy as a continuation of measures included in Klaus's 'small packages' of reforms. In contrast, the leader of the Social Democrats, Miloš Zeman, welcomed the decision of the provisional government, stating that it in a way draws on the programme of the Social Democratic Party. He claimed that the Social Democratic Party would continue to develop its policy if they won the elections.<sup>11</sup> The project to attract FDI, and the investment incentives in particular, came to be perceived as a Social Democratic project. The opposition ODS would very much use this interpretative framework in its attacks on the Social Democrats and their policies. ČSSD would reinforce this interpretation to demonstrate the successes of its economic policy.

By 1997, there was indeed an implicit consensus within the Social Democratic Party about the desirability of foreign investment support. A group of economists around former Minister of Industry and Trade, Jan Vrba, which included Jan Mládek, Pavel Mertlík, and Jiří Havel, represented the main proponents of such a strategy. They were assigned to develop industrial policy for the party. However, in the time leading up to the elections, there were also quite vocal nationalistic statements, making references, for instance, to the 'family silver,'

<sup>9</sup> E.g. 'Chybí investiční pobídky, tvrdí analytici' (Analysts: Investment Incentives Are Lacking), *Lidové noviny*, 1 October 1997.

<sup>10</sup> E.g. 'Vláda dala najevo, že stojí o cizí capital' (The Government Made Clear It Is Interested in Foreign Capital), *Mladá fronta Dnes*, 30 April 1998.

<sup>11</sup> 'Kabinet výrazně podpořil cizí i domácí investory' (Cabinet Strongly Supported Foreign Investors), *Profit*, 4 May 1998.

coming from parts of the ranks of the Social Democrats. It was understood that Miroslav Grégr, former manager of the state-owned enterprise Desto and a major adversary of Vrba within ČSSD, was the main proponent of economic nationalism in ČSSD.<sup>12</sup> Havelka recalls a situation where he was attacked by Grégr at a parliamentary committee for bringing competitors into good Czech enterprises. Grégr himself claims that he was in favour of creating Czech capital in the early 1990s. He believed that 'national capitalism' with limited FDI inflow would be viable if enterprises were restructured by the state before being privatised.

After the elections in July 1998, the Social Democrats came to power. They made foreign investment support, including the investment-incentives scheme, the flagship of their economic and industrial policy. This included not only supporting the incentives scheme, but also relying on foreign investors in the remaining privatisation cases. The Social Democrats would use the successful cases of privatisation to foreigners, such as Škoda-Volkswagen, as examples that such a strategy works. Moreover, they could already use the first wave of investors who were granted investment incentives. The scheme of investment support was met with great interest from investors. Only one month after it was introduced, CzechInvest reported there had been 111 applicants. Zeman, as the new prime minister, took part in the opening ceremony of the Matsushita plant, which marked the success of the project to attract investment. For investors, this was a sign of the new government's strong commitment to the investment-incentives scheme. For CzechInvest, which was put in a position of uncertainty after Grégr became the Minister of Industry and Trade, it became clear that it would find strong political support within the government. Indeed, Grégr jumped on the bandwagon of foreign investment support.

After the elections in 2006, ODS formed the government. One of the most vocal critics of the investment incentives scheme, Martin Říman (ODS), became the Minister of Industry and Trade. Based on the bold statements of ODS politicians in the Opposition, there were many reasons to expect a scaling down of the investment schemes. Shortly after Říman took the post, he introduced an amendment to the law on investment incentives, which he presented as a major change in approach.<sup>13</sup> In fact, rather than changing the state strategy, this amendment included retargeting investment support to more technology-intensive activities, as had actually been planned by the ministry and CzechInvest before Říman and ODS took power. Thus, ODS was implementing an adjustment to the incentives that would have been made anyway. Therefore, the Social Democrats had no objections to supporting the amendment in Parliament.<sup>14</sup>

<sup>12</sup> It must be noted, however, that Grégr participated in the privatisation of Škoda to Volkswagen, which he later very much boasted about.

<sup>13</sup> See 'Říman vyhlásil stop montovnám' (Říman: Stop Assembly Plants) *iHNed.cz*, 19 October 2006.

<sup>14</sup> See also J. Drahekoupil, 'Is CzechInvest Facing Extinction?' *Czech Business Weekly*, 7 May 2007, <http://www.cbw.cz/phprs/2007050702.html>.

### **Conclusion: political support for the competition state**

The reorientation of Czech industrial policy underscores the importance of structural pressures in steering state strategies in the direction of competition. Negotiations with investors proved to be key mechanisms for translating the structural power of transnational capital into policy outcomes. At the same time, the project of the competition state was promoted within the state by a group of state managers, the state fraction of the comprador service sector. It organised a coalition of forces promoting the competition state. Mediated by the activities of this group, the structural power of capital brought the comprador service sector into a prominent position in domestic politics. The EU provided important support to the activities of the comprador service sector in the early 1990s. Later, EU regulation effectively precluded attempts to promote national capitalism. The Czech story shows that the actual support for the competition state cuts across party lines, the political rhetoric notwithstanding.

Externally oriented strategies became predominant all across the V4 by 1999. They have been pursued by governments regardless of the ruling party coalitions [cf. Bohle 2006]. Political support for the competition state goes beyond narrow short-term interests and immediate material concessions, as was largely the case with the national projects of the early 1990s [Drahokoupil 2008: Chapters 3 and 4]. The wide embracement of the competition state has to be related to the structural environment, which produces a field of force that not only puts constraints on possible strategies, but also makes the externally oriented strategy a 'comprehensive programme' for societies in the region. These structural features also include dominant interpretative/ideational frames. In this context, the 'business school notion of globalisation' – including the assumption of perfect capital mobility and capital's insistence on pursuing neo-liberal policies – that is popular among policy makers is particularly important. The structural field of force shapes the 'field of the politically thinkable' [Bourdieu 1984] and thus makes the externally oriented project not only a positive programme, but also a framework of thinking that facilitates the articulation of various ideological positions, including resistance, on its own terms. The intellectuals of the competition state can thus defend investment subsidies even from 'a market perspective', according to which the policy, rather than being a market intervention, actually reflects relations in the global market for investment and in particular the excess of demand for FDI over its supply.

The structural power of multinational capital was crucial for reorienting state strategy in the Czech Republic. However, contrary to the state-centric understanding of state-multinational bargaining [Vernon 1998; Eden, Lemway and Schuler 2005; Meyer and Jensen 2005], implementation of the competition-state project cannot be understood just as the outcome of the unequal distribution of power between foreign investors and governments. As mentioned above, governments are not social actors independent of other social forces, such as investors and their allies. As the actual policy outcomes are a product of the agency of

particular social forces mediated through structures of representation centred on and within the state, it is the privileged position of social forces connected to FDI, the comprador service sector in particular, within respective states and societies that explains the support for the competition agenda.

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